DOW THEORY LETTERS INC.

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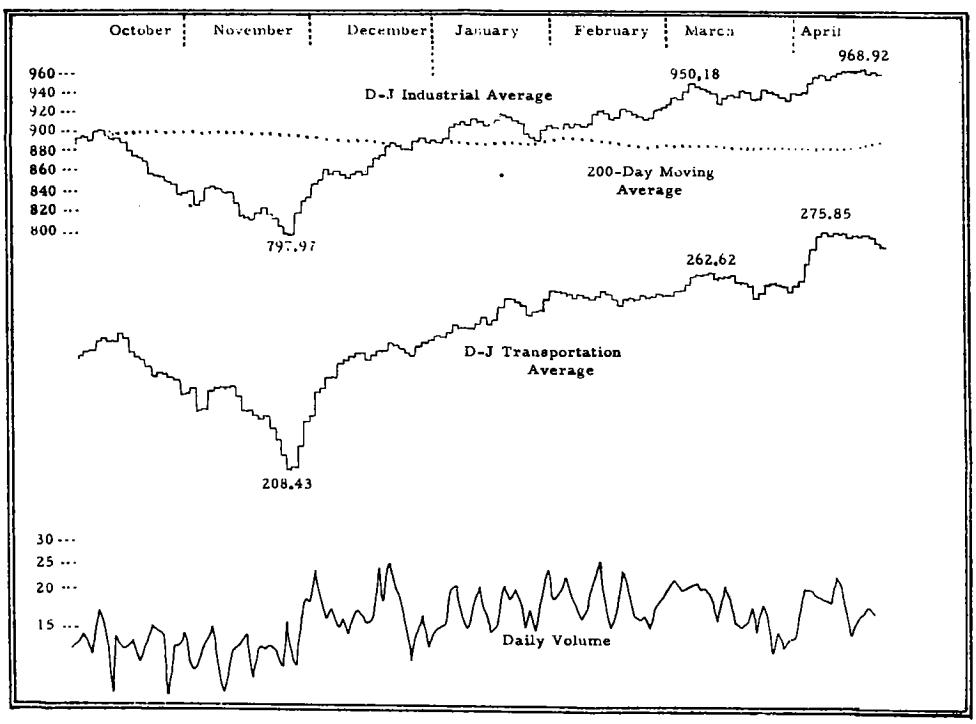
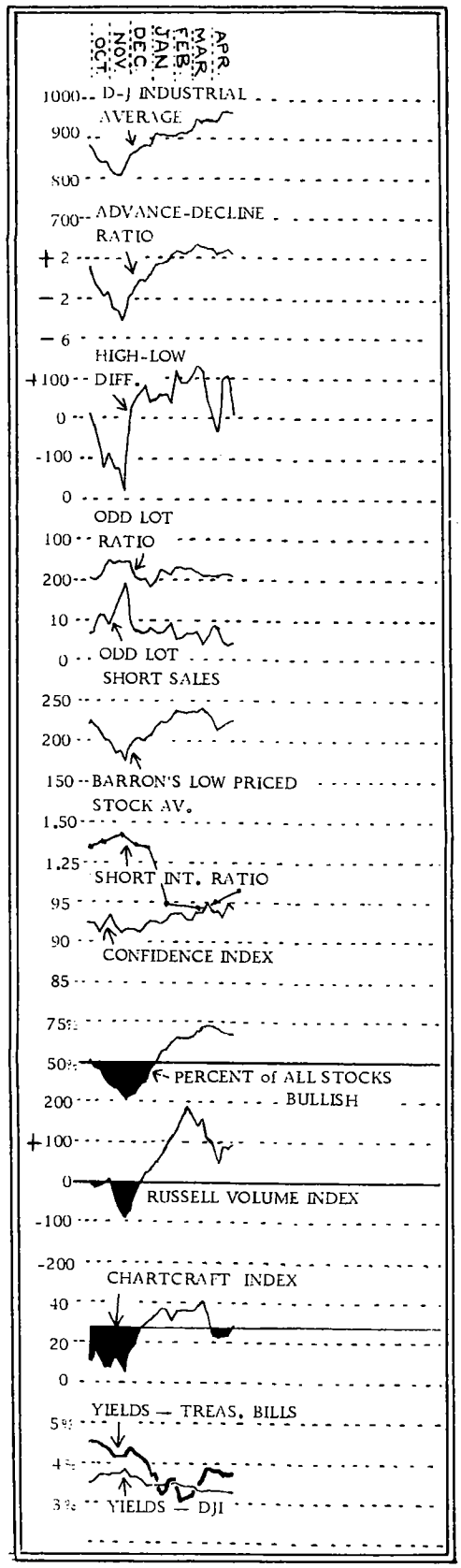
THE PICTURE: If the Dow is to sweep over the 1000 mark, nobody can say that Wall Street is not prepared for it. In March margin debt jumped by almost half a billion dollars, bringing the grand total of margin debt to $6.6 billion, an all-time high. Margin accounts are being opened at a frantic rate (20,000 in March), and boardrooms are crowded. The word is out that while the mutual funds are having tough sledding and are not really in a position to add to Wall Street's buying power (see Letter 525, page 4), the pension funds and insurance companies have taken up the slack and are suddenly frantic to make up for all the time lost since 1949.

The actual statistics are amazing. The change in net purchases of common stocks between the year 1969 and 1971 are as follows: (Non-insured) company pension funds up 78% in common stock purchases, life insurance companies up 127%, property and liability insurance firms up 147%, and mutual funds down 82%. The slack brought on by mutual fund redemptions was more than made up by the purchases of other funds and pension funds. Thus, the philosophy of common stocks has finally invaded the most staid financial sanctuaries, and the nation is now less prepared than ever for major trouble or a major primary bear market.

I have been struck by some of the observations of the Money & Credit report (767 Fifth Avenue, N.Y.C. 10022), and I am taking the liberty of including a few thoughts from their latest mailing (April 13): "The balance of this decade will see the most far-reaching economic and political social restructuring this country has ever seen. Here is the sequence we see. First, demands will be made on the system that will not be handled in the usual way. Interest rates will rise. Inflation will not be contained. The economy will improve only moderately despite massive stimulative efforts. The international problem will not go away. After a relatively brief period of time the disenchantment and disillusionment will effectively stay



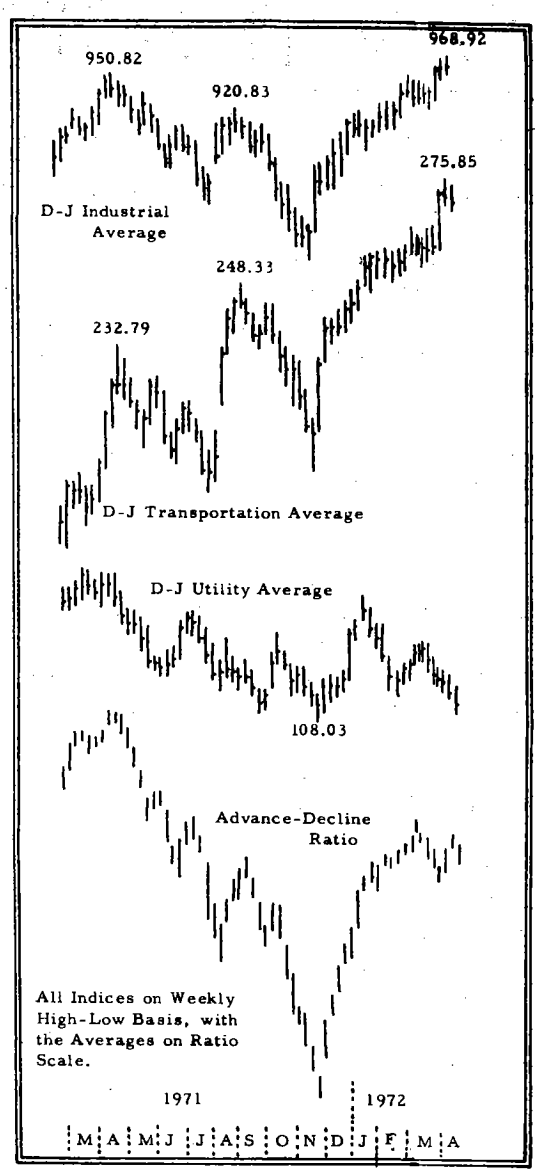


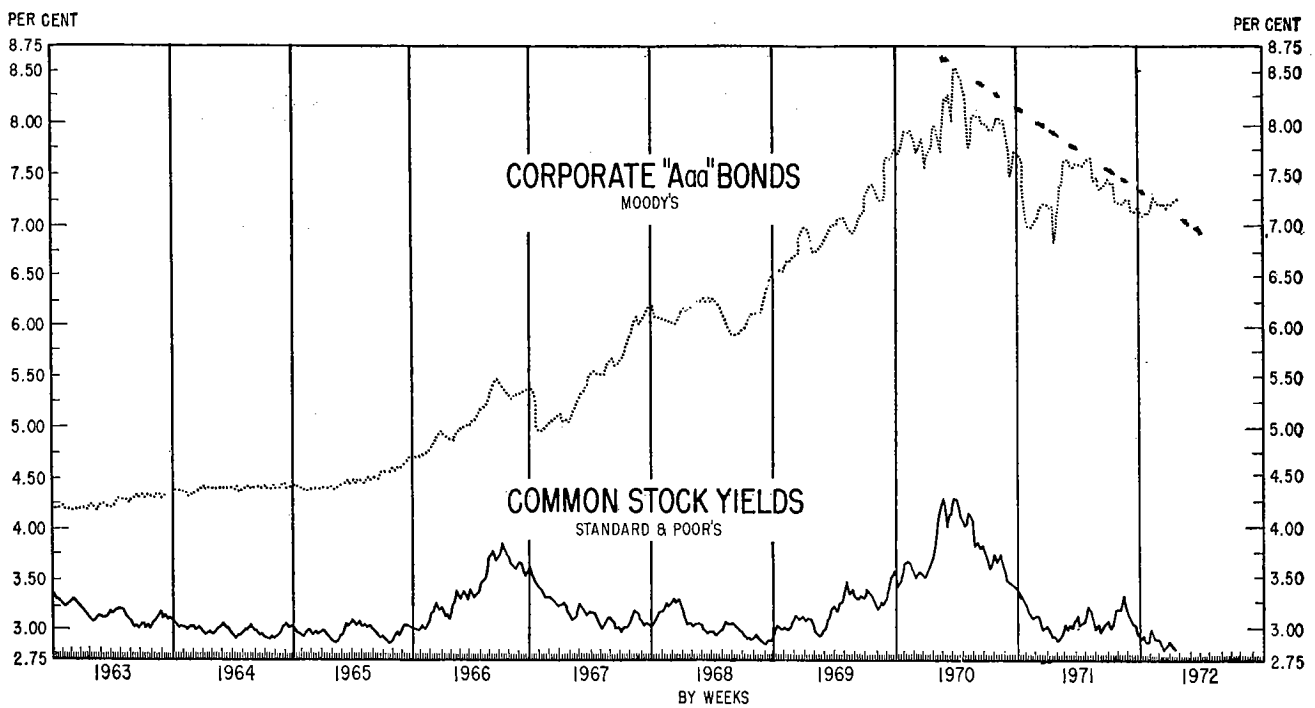
the hand of the consumer and the investor and serious dislocations will begin. We are now at the beginning of the final stages..."

There is little I can argue with in the above summary, except that the "unexpected" will often speed up the underlying or fundamental conditions. For instance, the Vietnam War has now heated up, and Hanoi is obviously putting the pressure on the Administration and on South Vietnam. With a visit to Russia coming up, with an election in the fall, with an election promise of a calming down of the Vietnam War, the President, according to the words of the acute Evans-Novak Political Report (April 12) "...is confronting a potential disaster that could destroy his re-election chances." Hanoi knows this, and while Mr. Nixon has few options, North Vietnam has many, and they can be expected to try them. I use the heightened Vietnam mess merely as an example of an unexpected change which could upset the economic calculations. Actually, I consider the monetary picture (from the standpoint of the stock market) more serious than Vietnam.

The monetary front, last week, was punctuated by tightening money all around and a jump in the prime rate (the bank rate charged the top-rated corporations) to 5.25%. The Consolidated Edison syndicate broke up with a fat loss on $150 million of 30-year bonds, bonds which promptly broke below par (below 100) to yield 8% for these Single-A rated debt instruments. The next step for the long-term bond picture will probably be the 9% and over range in yields, thus bringing in even more vicious competition for the stock market.

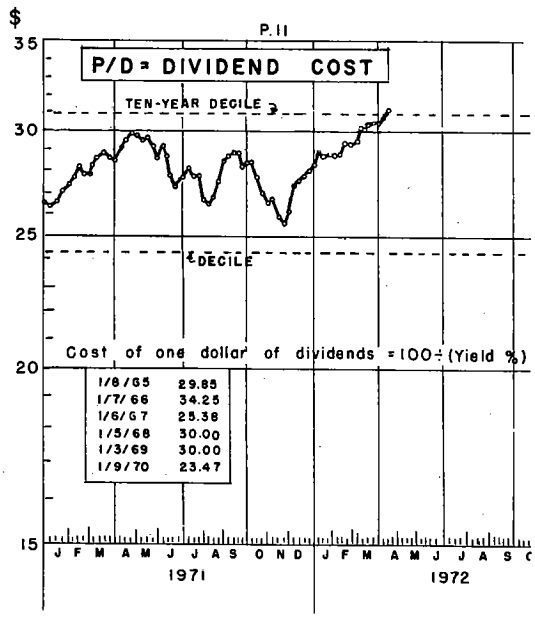
Incidentally, most people have little idea of how massive the current spread is between yields on stocks and bonds. The chart on this page from the Weekly Bond Buyer shows yields on Standard & Poor's 500-Stock Index in the 2.80% area, or near a record low, while yields on Aaa bonds are nearing 7.25%. Note also that bond yields have reversed the declining trendline which has been in effect since mid-1970, and this suggests rising bond yields (and falling bond prices) against a stock market that is as nearly "over-priced" on the basis of dividend yields as it has ever been. Currently the inverse yield spread in favor of bonds over stocks is at a near-record 4.43%, far greater than the 3.50% spread





which ushered in the '69-'70 smash (see section on bonds further on in this Letter).

Merrill Analysis (Box 228, Chappaqua, N.Y. 10514) puts the picture another way in its "dividend cost" chart (which I reproduce). Here we see the cost of a dollar of dividends rising to above $31, which puts the dividend cost in the "expensive" or "speculative" range, an area not seen in early 1969.

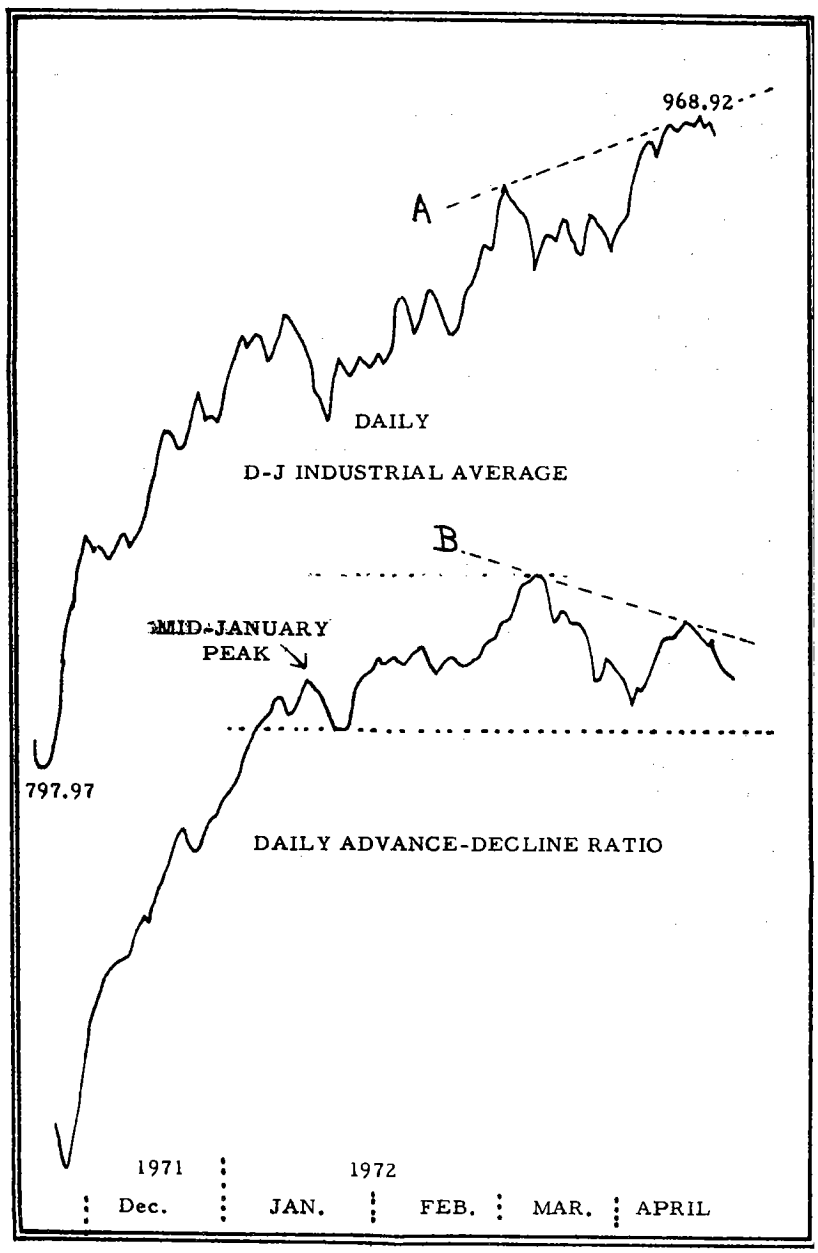


To turn to the action of the market itself, April saw a breakout of both the Industrial and Transportation Averages above their March peaks, and this included the Industrial rally above its April, 1971, peak of 950.82. From this standpoint, the market appeared "bullish" enough on the face of it. Then an event occurred which I have been warning about. On April 13 the bellwether D-J Utility Average broke to a new 1972 low (a phenomenon which was greeted with strange silence on the part of Wall Street).

All during the great 1949 to 1966 primary bull market, it was the Utility Average which led the market up. But since then the Utilities have been in a massive downtrend, and this is not without its ominous implications. Referring to the page 2 weekly chart, subscribers can see that the Utility Average is now in a precarious position, perched just above its November 24, 1971, low close of 108.03. If this level is broken, the Utilities will be back in their 1970 range, just 13 points above the 1970 bear market low of 95.86.

I have included studies in the past of areas wherein both the Utility and the D-J bond Average were traveling down together, and almost uniformly such areas spell trouble for the stock market. I believe we are entering such a zone now, and already we are seeing much churning and hesitancy on the part of stocks.

The accompanying daily chart of the D-J Industrials and the advance-decline ratio points up this situation, and it is well to note that since March 9 the Dow and the A-D ratio have been diverging, and this outstanding divergence is delineated on the chart by the Trendlines marked A and B. (See later section of this Letter regarding an even larger divergence between the Dow and the A-D ratio). Another important observation is that the A-D ratio at present is at about its mid-January value, and this suggests that under the guise of record volume and massive churning, a great number of stocks have made little or no upward progress during 1972.



It must gaul the Administration to realize that when Mr. Nixon took office on January 20, 1969, the Dow stood at 931. Since then it has risen as high as 968 or 4% above the level at which Mr. Nixon assumed office. The Dow has, since the President took office, also been as low as 631, a drop of 32%. In other words, the Dow has dropped 8 times further than it has gained in all the period since Mr. Nixon took office, and the whole story has not yet been told.

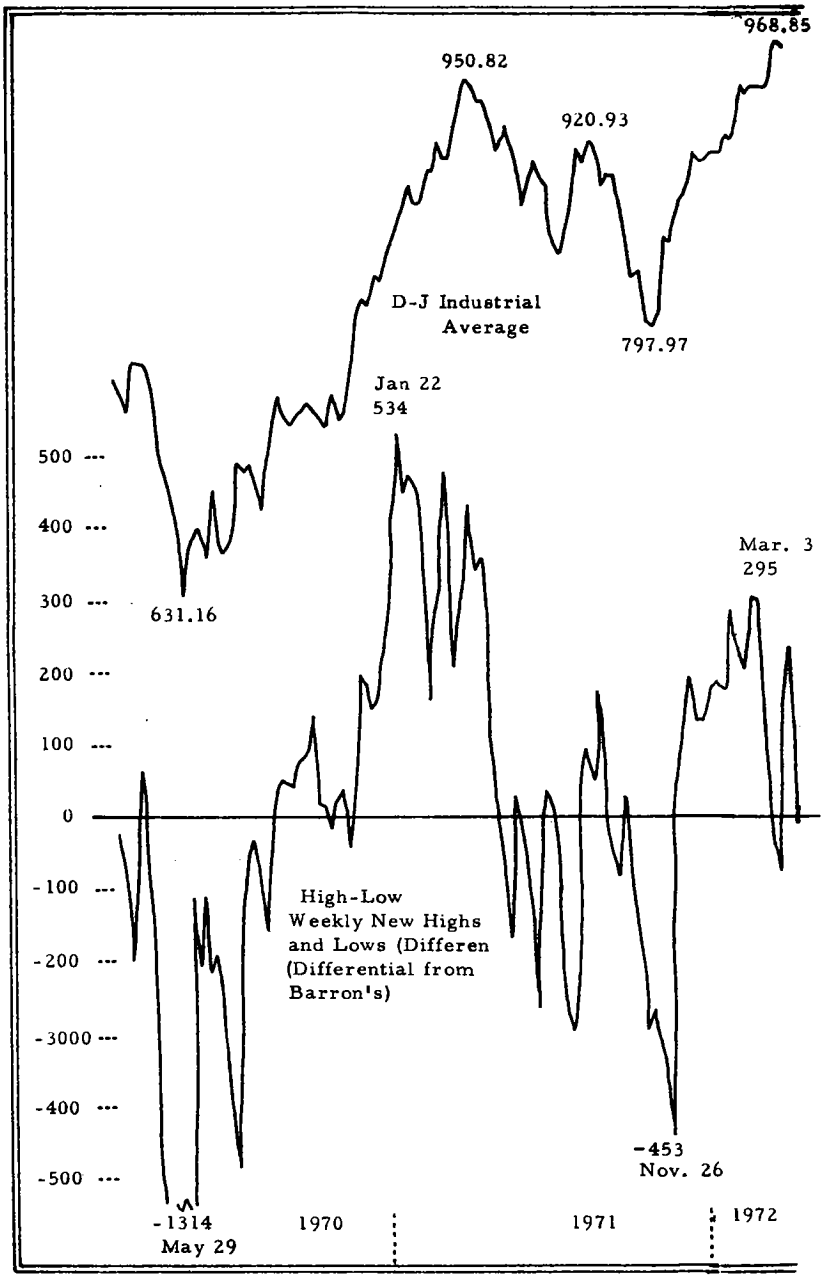
TECHNICAL PROBLEMS: The weekly chart on page 2 shows a series of declining tops on the advance-decline ratio, starting with the April, 1971, high, then the lower March, 1972, high and most recently the still lower minor peak of April 12 (the April 12 peak was

recorded despite new recovery highs for the Dow Industrials). The whole picture since April, 1971, is one of persistent divergence between the Dow Industrials and the mass of stocks on the N.Y.S.E. as gauged by the advance-decline ratio.

The page 4 chart of the weekly new highs and lows (differential) would seem to confirm this same divergence. I have included the weekly high-low chart going back to early 1970. Figures for this chart are computed by simply noting the plurality of new highs over new lows for the week (or vice versa if new lows outnumber new highs). These tabulations appear in each issue of Barron's as well as in the Sunday edition of many leading newspapers. For instance, if there were 400 new highs for the week and 150 new lows, the differential would be a plus 250, and this figure would be entered on the chart.

The peak of strength for the high-low index was recorded on the week ending January 22, 1971, (see chart) and this was approximately three months before the April, 1971, top on the A-D ratio. Deterioration followed the first quarter, 1971, strength, and by November of that year the Dow had fallen to a low close of 797.97. Along with this decline came a low reading of minus 453 for the high-low chart.

The new advance took the advance-decline ratio to a 1972 peak on March 9, and this is shown on the page 2 weekly chart. On the high-low chart we see a peak of 295 recorded on March 9. It is significant that the 1972 reading was far below the 1971 peak reading of 534.



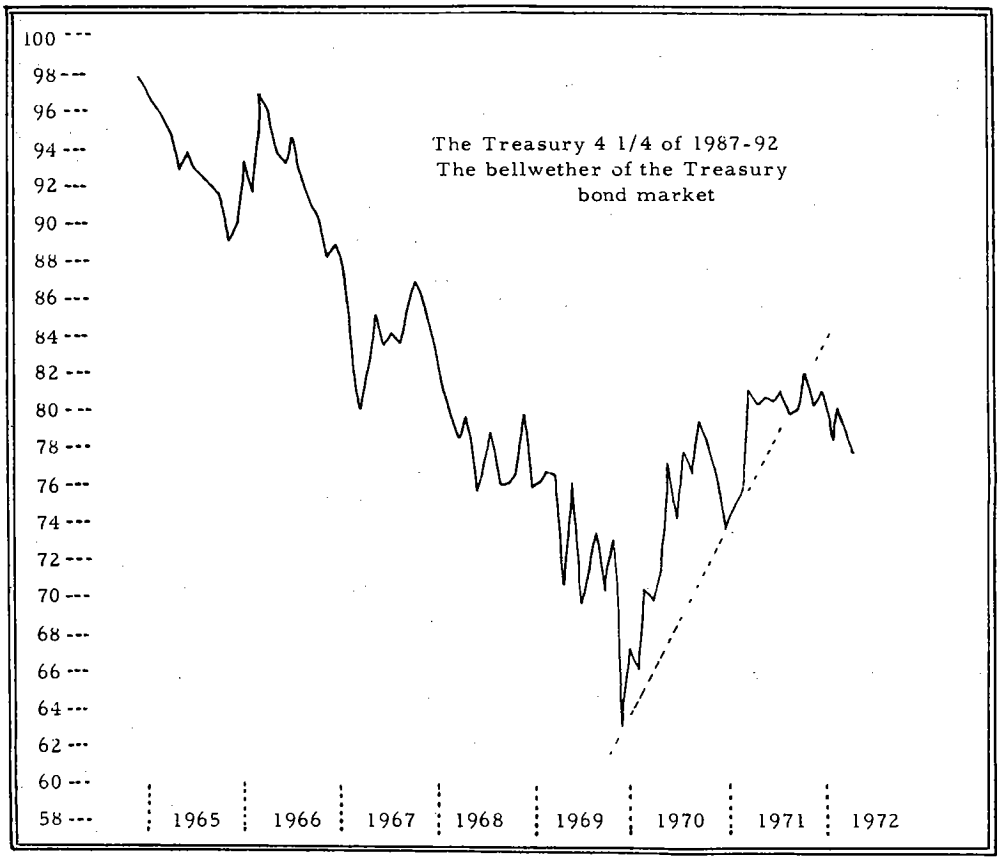
Now in April, with the Dow Industrials having established new recovery highs, we see the A-D ratio below its March peak and the high-low index still below its own March peak. This represents an ebbing of technical strength, and sets up the technical formula for trouble in the midst of an area which I have designated as one of massive distribution.

BONDS AND INTEREST RATES: In the last Letter I wrote that the current and recent wildfire expansion of the money supply together with its results (rampant inflation) are rekindling all the ills of the past five years. And one of these ills is trouble in the money markets.

I include on page 5 a monthly chart of the bellwether of the U.S. Treasury bond market, the 4 1/4's of 1987-92 (chart based on bid price for the bond at the first of each month). Here we see this widely-watched bond down to the 76 level, and of course this means that the buyer pays around $760 for each bond (which matures at a full price of $1000). At that price (and including appreciation of the bond to maturity) the buyer enjoys a return of 6.20% annually.

Note that the ascending trendline from the 1969 low has now been broken and the bond now appears to be in a definite downtrend. I consider this pronounced reversal in the 4 1/4 bond most significant, and I would say that it represents the return to a broad trend towards higher interest rates. I have been warning about this for many weeks now, but it seems as if the bond market has just started to take cognizance of the situation.

The little clip (page 5) from the front page of the April 14 Wall Street Journal would seem to testify as to the "surprise" of the bond market as syndicates broke up last week and took losses of over one million dollars in bonds which they had bid too high on.



But to me, the bell sounded for rising interest rates when, on April 13, the D-J Utility Average broke to a new low for 1972. This was another possibility which I have been warning about, and I consider the new low for the Utility Average to have bearish implications for both the bond and stock markets.

Bond underwriters gave up trying to sell on their terms the substantial remainders of three recent issues that had totaled $365 million. The decision meant, for instance, an indicated net loss of over $1.1 million for a syndicate that handled a Con Edison offering.
(Story on Page 19)
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In a recent column, economist Eliot Janeway states that he had felt that a Federal borrowing rate of $25 billion a year could be handled by the Government without necessarily upsetting prices and wages. "This is still my assumption," writes Janeway, "But a Federal borrowing operation on twice this scale, with a prognosis for more, not less, next year points to controls that will stick and be sharp."

I would agree with Janeway on this analysis, and I expect that unless we have a market collapse before election time, we will have a new and more stringent set of controls after election time. And the new controls could well include corporate profits.

GOLD AND MONEY: In an article ("The Dynamics of Solid Waste") appearing in the Technology Review (March-April issue), Jorgen Randers and Dennis Meadows of M.I.T. list 19 resource materials from aluminum to zinc and calculate (on the basis of various growth and usage rates) how long each commodity will last. Coal was given the longest period, and the authors state that coal will last for 111 years. Iron resources will last 93 years, lead 46 years, petroleum 20 years, silver 13 years. At the bottom of the list is gold with resources to last 9 years! Aside from monetary pressures, is there any wonder that the price of gold is heading higher?

Last week a subscriber sent me this fascinating column (page 6) regarding the Russians and gold. I have stated before that in the economic war, the Russians could gain a huge advantage by making the Ruble convertible into gold in the face of the inconvertible dollar. In view of this, I found this column doubly interesting. Perhaps if a European currency is inaugurated, the Russians will join in the venture or at least make the Ruble exchangeable at a fixed level with the European currency.

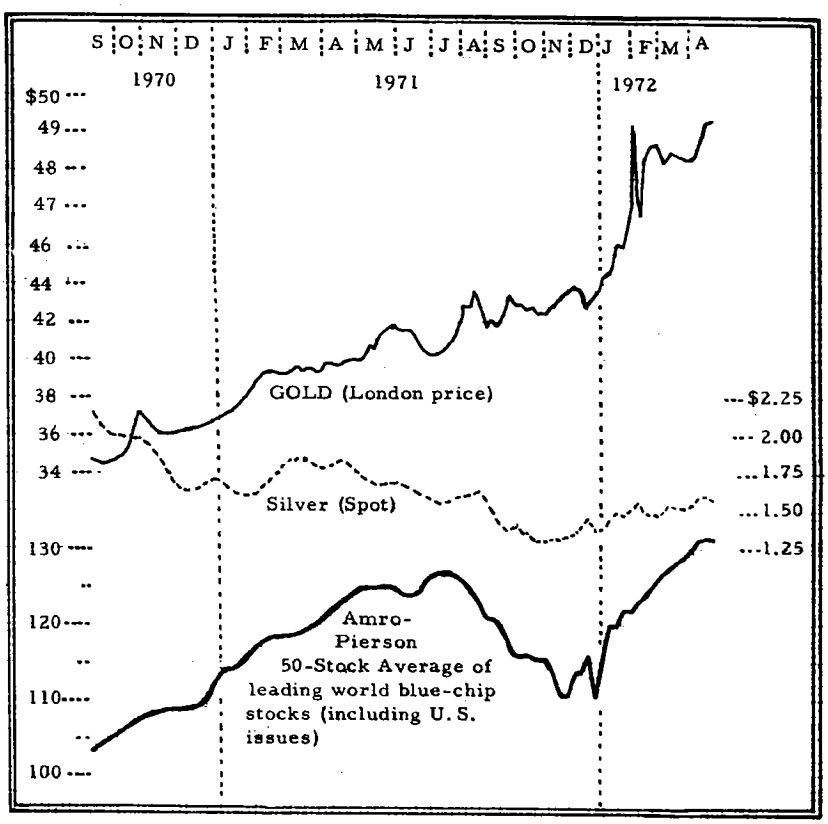
In the Swiss publication Swiss Economic Viewpoint (published by the Foreign Commerce Bank, Inc.) three alternative possibilities are listed as outcomes to current U.S. inflation and money printing: (1) A "massive increase in the official gold price and a return to convertibility..." (2) The building of an entire new monetary system which would replace the current

reserve dollar, (3) "It could end in a worldwide runaway inflation, a complete collapse of what is left of the world monetary system, stagnation of international trade, and a prolonged worldwide depression..."

In the face of these three possibilities, I personally believe that the U.S. will be forced to raise the price of gold to substantially higher levels. Such a procedure is also in keeping with the "complete reversal" syndrome which seems to be an integral part of President Nixon's character.

In Alden Wells' Monetary Report (which just arrived) Mr. Wells notes that the whole European picture is accelerating. Mr. Pompidou has announced that the Common Market meeting on finances will be held this Fall, and that Mr. Pompidou will be chairman. At that meeting, thinks Wells, Europe will raise the price of gold to "probably $100 per ounce."

Harry Schultz's always fascinating report arrived today, and Dr. Schultz states that monetary controls are under "heavy consideration." Writing from Tokyo, the peripatetic prophet thinks there will be controls on travel, on foreign purchases, transfer on funds abroad, foreign investments. In short, it is going to be very difficult or next to impossible to move funds or assets out of the U.S. For this reason, states Schultz, "I would guess the value of foreign securities already 'inside' the U.S. prior to inauguration of controls, will increase substantially. Thus ADR's should go to a substantial premium over the market quotations abroad for the same securities..."



Russia calls for return to gold

By Michael Simmons

IN A RARE pronouncement on the position of gold in the international monetary system, the Soviet Union has publicly declared in favour of a return to the gold standard.

Mr. Sergei Shevchenko, a senior civil servant in the Soviet Ministry of Foreign Trade, told the Cuban news agency, Prensa Latina, that "the present serious monetary problem will have to be solved at a truly international meeting on the basis of gold."

The Russians are one of the world's leading gold producers, though they maintain the utmost secrecy about output and sales on the international markets. They are also becoming increasingly active on the international money markets.

For these reasons, they have an obvious if hardly ever disclosed interest in gold prices and the rates of major international currencies.

Mr. Shevchenko was reported as saying that the Soviet Union did not feel that one currency, or even several currencies from several countries, could be the basis for international trade. "World trade," he declared, "must rest on a more solid foundation, and that foundation can only be gold."

He claimed that the Russians saw no other possibility, but that, one way or another, it had to be achieved. "We are convinced that gold should be the basis of everything."

Any other reserve instrument would be too unstable in this context, and the International Monetary Fund, because it mainly represented "the rich capitalist countries," would not necessarily solve current problems, he added.

On April 13 the price of gold on the free market (London) jumped to a new record high of $49.35. This is seen on the weekly chart on this page, and it is clear that the trend of the gold price is stubbornly upwards, as it has been all through 1970 and 1971. Silver is still off its 1971 base, but it has not begun to act like the yellow metal. C.V. Myers puts the gold price picture in rather dramatic terms when he writes, "It took three-and-one-half years for gold to rise seven dollars per ounce. It has taken six months for gold to rise the second seven dollars per ounce. This is the kind of acceleration in price which I have always pictured..." (from Myers Finance Review, P.O.Box 5531, Postal Station A, Calgary 9, Alberta, Canada). Myers, like Harry Schultz, believes the time is near when Europe will raise the price of gold, and Myers believes that the rise will be a "multiple" of the present price.